



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date:	08/26/13	Bill No:	Assembly Bill 777
Tax Program:	Property	Author:	Muratsuchi
Sponsor:	SpaceX	Code Section:	RTC 242
Related Bills:		Effective Date:	Upon enactment

BILL SUMMARY

This bill exempts from property tax qualified space flight property, including fuel, until the 2023-24 fiscal year.

Summary of Amendments

Since the previous analysis, this bill was amended to limit retroactivity to January 1, 2013, require evidence to support the exemption, if requested, and exempt only taxpayers that have a primary business in space flight activities.

ANALYSIS

CURRENT LAW

Except where the law provides a specific exemption, the property tax applies to all property, both real and personal. The law imposes the property tax on tangible personal property items used in a trade, profession, or business.¹ Currently, there is no specific property tax exemption for space flight property. Such property, however, may qualify under the business inventory exemption if the criteria are met.² The law exempts business inventories, while supplies are taxable.

- Supplies are items used in the normal operation of the business and are not intended for sale or lease.
- Business inventory, on the other hand, include all personal property that becomes part of or are themselves a product that is held for sale or lease. It also includes raw materials and work in progress with respect to such products.

The Constitution authorizes the Legislature to statutorily exempt any personal property from property tax with a 2/3 vote of each house.³

PROPOSED LAW

This bill exempts from property tax qualified property for use in space flight for lien dates 2013 to 2023, inclusive.⁴ "Space flight" means any flight designed for suborbital, orbital, or interplanetary travel by a space vehicle, satellite, space facility, or space station of any kind.

¹ RTC §224

² RTC §219, RTC §129, Regulation 133

³ Article XIII, Section 2 of the California Constitution

⁴ These lien dates correspond to the 2013-14 to 2023-24 fiscal years.

The exemption is limited to taxpayers that have a primary business purpose in space flight activities. The exemption does not apply to any material that is not intended to be launched into space.

“Qualified property” includes:

- Tangible personal property that has space flight capacity. This includes an orbital space facility, space propulsion system, space vehicle, launch vehicle, satellite, or space station of any kind, and any component thereof.
- Tangible personal property that is the raw materials or work in process or finished goods, that has, or upon manufacture, assembly, or installation, has space flight capacity.
- Tangible personal property to be placed or used aboard any facility, system, vehicle, satellite, or station described above.
- Fuel produced, sold, and exclusively used for space flight and not adaptable for use in ordinary vehicles.

The assessor cannot deny the exemption because:

- The space flight launch fails, is postponed, or is cancelled.
- A launch vehicle, or any component thereof, is destroyed.

The exemption goes into immediate effect and applies retroactively to the January 1, 2013 lien date for the 2013-14 fiscal year.

IN GENERAL

Business Personal Property. Personal property used in a trade or business is generally taxable. Annually, the law requires property owners to report their cost on a business property statement⁵. Proposition 13's value limitations do not apply to personal property, which is valued each lien date at its current fair market value.

Generally, the assessor determines the fair market value using the property's acquisition cost. The assessor multiplies acquisition cost by a price index (an inflation trending factor based on acquisition year) to estimate reproduction cost new. Next, the assessor multiplies reproduction cost new by a percent good factor (from BOE-issued percent good tables) to estimate depreciated reproduction cost (reproduction cost new less depreciation). The assessor uses the reproduction cost new less depreciation value as the property's taxable value for the fiscal year. The tax rate applied to the value is the same as the rate on real property; that is 1% plus voter approved indebtedness, which varies by locality.

Business Inventory Versus Supplies. The BOE's Assessors' Handbook 504 (AH 504), [Assessment of Personal Property and Fixtures](#), explains it is important to distinguish supplies, which are assessable, from inventory items, which are exempt. In short, business inventory includes all items of personalty that become part of, or are themselves, a product that is held for sale or lease in the ordinary course of business. For an item of property to qualify for the business inventory exemption, the key phrases *ordinary course of business* and *goods intended for sale or lease* must apply.

The AH 504 provides that business inventory generally includes:

- Goods transferred in the rendition of a “**nonprofessional service.**”

⁵ RTC §441

- Items incorporated into a product and held for sale in the ordinary course of business.

Supplies include:

- Incidental goods transferred in the rendition of a “**professional service**” unless the goods are regularly billed separately from the service.
- Items consumed in the manufacturing process but not physically incorporated into the product.

The AH 504 notes that many services are difficult to classify as a professional or nonprofessional service but provides the following criteria to help assessors make the determination:

Professional Services: A "profession" is a vocation where the labor and skill is predominantly mental or intellectual, rather than physical or manual. A "profession" requires knowledge of an advanced type in a given field of science or learning gained by a prolonged course of specialized instruction and study.

Property Tax Rule 133 lists as examples: medicine, law, architecture, or accountancy.

Nonprofessional Services: A "nonprofessional service" is generally defined as a vocation requiring skill of a manual or **mechanical nature**. Courts tend to classify a "nonprofessional service" as a business as opposed to a profession. Examples noted include barbers, carpenters, and plumbers.

Property Tax Rule 133 lists as examples dry cleaners, beauty shop operators, and swimming pool service companies.

COMMENTS

1. **Sponsor and Purpose.** According to the author, this bill ensures that California's brilliant space technology innovators stay in business by nurturing a productive business climate for the state's aerospace sector. The sponsor, Space Exploration Technologies (SpaceX), designs, manufactures and launches rockets and spacecraft.
2. **The August 26, 2013 amendments** change the effective date from January 1, 2007 to January 1, 2013, limit the exemption to those taxpayers that have a primary business purpose in space flight activities, and require taxpayers to provide evidence to support exemption eligibility upon the assessor's request. **The May 21, 2013 amendments** added sunset provisions to make the exemption temporary.
3. **The Legislature may tax or exempt property in its discretion.** Because space flight property is classified as personal property, the Legislature legally may exempt it, provided they do so by a two-thirds vote of both houses. Section 2 of Article XIII of the California Constitution provides that the Legislature, two-thirds of the membership of each house concurring, may classify personal property for differential taxation or for exemption.
4. **The exemption is retroactive to January 1, 2013.** A public purpose statement supporting retroactivity states the bill promotes businesses within the state that consistently expand and provide secure employment in a much needed industry.
5. **The issue giving rise to this bill.** As previously noted, the law exempts business inventories, while supplies are taxable. The sponsor indicates that recently two of its propulsion systems – rockets used for space travel - were classified as “supplies”

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resulting in a \$2 million unexpected property tax bill. The sponsor believes its rockets should be classified as inventory. Under existing law, the question is unsettled. This bill would make the determination of whether propulsion systems are inventory or supply unnecessary for the years this exemption is in effect.

COST ESTIMATE

The BOE's cost to update publications is absorbable.

REVENUE ESTIMATE

According to county assessors, this bill results in an annual revenue loss of at least \$1.1 million.

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